

MINUTES
LEGISLATIVE GOVERNMENT OVERSIGHT COMMITTEE
July 18 & 19, 2006

The Legislative Government Oversight Committee met July 18, 2006, in the Supreme Court Chamber at the Capitol. Chair Representative Alons called the meeting to order at 1:08 p.m. Other members present were:

Senator Tom Courtney, Chair
Senator Ron Weick
Senator Mike Connolly
Senator Pat Ward

Representative Dwayne Alons, Chair
Representative Joe Hutter, VC
Representative Vicki Lensing, RM
Representative Clel Baudler
Representative George Eichorn
Representative Wes Whitead
Representative Cindy Winckler

APPROVAL OF MINUTES

Minutes from the June 26 & 27, 2006, meeting moved by Senator Courtney and approved by the Committee.

CIETC INQUIRY

David Vaudt, Auditor of State, was accompanied by Tami Kusian, Deputy Auditor of the Performance Investigation Division, State Auditor's Office. Mr. Vaudt discussed issues involving audit procedures and controls and the limits of an audit when managers conspire to deceive the auditor. Mr. Vaudt discussed the integrity of CIETC officials and the degree of oversight performed by the board of directors known as Local Elected Officials (Board) and Iowa Workforce Development (IWD).

Mr. Vaudt also discussed the employment in his Office of Ms. Deborah Dessert, who heads the Professional Development Unit in his Office. Ms. Dessert's husband is John Bargman who served as CIETC's Chief Operating Officer during the period of investigation. In response to a number of questions, Mr. Vaudt stated that Ms. Dessert's duties involved training and recruitment and that she had not been informed about the State audit of CIETC. He stated that his Office is in contact with Iowa Ethics and Campaign Disclosure Board, the Iowa Accountancy Examining Board, and the American Institute of Certified Public Accountants regarding Ms. Dessert's work relationships. He noted that Ms. Dessert began working in his Office in January 2005, with the understanding that she would wind up her consulting work in approximately six to twelve months. He also noted that during this period Ms. Dessert took leave without pay from the State Auditor's Office in order to perform consulting work that included working for CIETC. Mr. Vaudt stated that in November 2005, Ms. Dessert informed him that Mr. Bargman, her husband, may be the subject of an investigation. Mr. Vaudt stated that Ms. Dessert remains a paid employee of his Office and that he is awaiting the results of an investigation before taking any disciplinary action. Committee members doubted Ms. Dessert's testimony regarding her awareness of Mr. Bargman's level of compensation while he served at CIETC in calendar year

2005. During that period Mr. Bargman earned \$152,000 in salary and \$207,000 in supplemental payments. Several Members expressed concern about Ms. Dessert's continued employment at Office of State Auditor.

Mr. Vaudt also discussed the payment of bonuses to State employees, noting that supplemental payments may be an important incentive to attract and retain valuable employees. Members discussed an inquiry made to Mr. Vaudt by Ms. Cynthia Eisenhower, Chief-of-Staff for Iowa Governor Tom Vilsack, regarding the use of \$200,000 deposited in an economic development foundation. The moneys were designated for paying expenses associated with hosting the National Governors Association's annual summer meeting held in Des Moines in 2005. Mr. Vaudt stated that he expressed concern about the appropriateness of using the remaining moneys for the payment of bonuses. Mr. Vaudt also discussed an issue regarding the use of moneys earned from contributions made by members of the Iowa State County Treasurers Association and which are managed by Polk County pursuant to a 28E agreement (See Chapter 28E, Code of Iowa). Mr. Vaudt stated that according to the terms of an amended agreement, excess earnings are to be distributed to the participating counties.

Corporate Law Overview

Mr. Willard L. Boyd III, a member of the Nonprofit Corporations Committee of the Business Law Section of the Iowa State Bar Association, is an attorney with the Des Moines law firm of Nyemaster, Goode, West, Hansell & O'Brien, P.C. Mr. Boyd discussed the provisions of the Revised Iowa Nonprofit Corporation Act ("RINCA") codified in Chapter 504, Code of Iowa, that replaced the Iowa Nonprofit Corporation Act ("INCA") codified in Chapter 504A, Code of Iowa. According to Mr. Boyd, RINCA incorporates many of the recent amendments to the Iowa Business Corporation Act (incorporating the updates to the Model Business Corporation Act) codified in Chapter 490, Code of Iowa. Mr. Boyd referred the Committee to a publication entitled "The Iowa Principles and Practices for Charitable Nonprofit Excellence" developed by the Iowa Governor's Nonprofit Tax Force. Mr. Boyd noted that RINCA addresses many areas relating to directors and officers that are not addressed in INCA, including duties imposed on directors and officers of nonprofit corporations. Generally, RINCA adopts the duty of care standard set forth in the Iowa Business Corporation Act (Sections 504.831 and 504.843, Code of Iowa). RINCA also includes a provision addressing conflict of interest transactions that is based on the provision contained in the Iowa Business Corporation Act (Section 504.833, Code of Iowa). Mr. Boyd noted that nonprofit corporations are also governed by Internal Revenue Service regulations governing nonprofit corporations that seek to retain a tax exempt status under IRC Section 501(c)(3). In addition, a nonprofit organization is governed by the so called Sarbanes-Oxley Act (the Public Company Accounting Reform and Investor Protection Act of 2002) as enacted in Pub. L. No. 107-204, 116 Stat. 745, which sets record retention and whistleblower protection requirements for nonprofit organizations, and provides good practice for nonprofit organizations such as the requirement of an audit committee.

Mr. Boyd noted that CIETC was not organized as a nonprofit corporation but as a 28E organization authorized under State statute. Mr. Boyd noted that generally under principles of common law some duty of care and duty of loyalty exists. A duty of care involves exercising responsibilities in good faith and diligence, attention, care and skill (See Section 504.831, Code of Iowa) and is satisfied by attending board meetings regularly, entering discussions, reading minutes, learning about the organization's programs, maintaining a careful oversight of finances, and questioning unclear or troubling activity. A duty of loyalty involves placing the interests of the organization before the director's private interests (See Section 504.833, Code of Iowa). Conflicts of interests are managed rather than entirely avoided, approved by a vote of

disinterested board members after full disclosure. He also noted that unique to directors and officers of nonprofit corporations is a duty of obedience, including by carrying out the purposes and mission of the nonprofit organization, complying with federal and state law applicable to nonprofit organizations, and complying with the organization's governing documents (articles of incorporation and bylaws).

Attorney General's Office

Mr. Grant Dugdale, Assistant Attorney General in the Licensing and Administrative Law Division, representing Iowa Workforce Development, was accompanied by Mr. Eric Tabor, Chief of Staff. Mr. Dugdale noted that the federal government is implementing criminal and civil investigations of matters connected to CIETC. The Office of Attorney General is cooperating with federal authorities with the goal of facilitating the recovery process. He estimated that recovery could take up to 38 months with an amount in dispute between \$1.2 million and \$1.5 million dollars.

Specifically, Mr. Dugdale discussed two federal programs: (1) The Workforce Investment Act (WIA) funded by the United States Department of Labor and (2) The PROMISE JOBS Program funded by the United States Department of Health and Human Services. According to Mr. Dugdale, each program is governed by different funding procedures and standards. He stated that WIA provides for strong local control and accountability, but does not have stringent conflict of interest prohibitions. He noted that WIA reflects strong preference for local control; without a right for strong state involvement. The membership of Local Elected Officials (in the case for Region 11, Boone, Dallas, Jasper, Madison, Marion, Story, Polk and Warren Counties) as independent taxing authorities are solely liable for misused moneys payable from moneys not attributable to federal grants and according to a formula which prorates each member's liability. The PROMISE JOBS Program is funded as part of the Temporary Assistance for Needy Families Program (TANF) that relies upon a more traditional scheme in which the State of Iowa is the grant recipient and therefore liable for mismanagement of moneys. However, under a 28E agreement between the State of Iowa and CIETC, the State is entitled to be reimbursed for misappropriated moneys by the membership of Local Elected Officials according to the same formula used to assign liability under WIA. Mr. Dugdale noted that political subdivisions may be in the best position to bring actions for indemnification against individuals involved in mismanaging moneys.

According to Mr. Dugdale, the issue of overpaid salaries will be resolved based on whether the compensation payments were reasonable. He noted that bonuses are frozen while the Des Moines Area Community College (DMACC) is temporary managing the organization. He also commented that has been an evaluation of the CIETC compensation structure in order to establish a demonstrative factual basis for a revised compensation structure and that may involve decreasing and increasing salaries. He also noted that (IWD) has drafted a contract which limits reimbursement to 120% of an equivalent State position.

Committee Members expressed concern that salaries not be increased at this point. Mr. Dugdale also addressed issues relating to bonds held by individual Board members, but emphasized that the political subdivisions which are members of the organization are liable for reimbursing the United States Government and the State of Iowa.

RECESSED

Representative Alons recessed the meeting at 4:35 p.m.

July 19, 2006

Representative Alons called the meeting to order at 9: 02 a.m.

Private Audit of CIETC

Mr. Alan Kincheloe of the accounting firm Faller & Kincheloe, P.C. was accompanied by Roscoe A. Ries, Jr., Attorney at Law, from the law firm Whitfield & Eddy P.L.C. Mr. Kincheloe declined to give an opening statement but answered questions from Committee Members. Mr. Kincheloe referred to a letter addressed to the Committee dated May 23, 2006, that is on file with the Legislative Services Agency. He noted that Mr. Archie Brooks was the Board's Chairperson and discussed the appropriateness of accepting Mr. Brooks's verbal authorization as evidence of the Board's approval of compensation paid to CIETC employees. He also noted that Ms. Sherry Howard, Secretary/Treasurer of CIETC, regularly visited CIETC offices to review and approve all invoices for payment. Mr. Kincheloe stated that personnel from his firm were at the CIETC premises in October 2005, and had interviewed Ms. Howard. He explained that the purpose of the audit was to determine the accuracy of the organization's financial statements (whether they were materially correct), and emphasized that the audit was not intended to pass judgment regarding the appropriateness of compensation paid to employees as long as the compensation amounts were recorded in the organization's general ledger, approved by the organization's board of directors, and were made in accordance with the organization's contracts. He also stated that the United States Department of Labor (DOL) had conducted an analysis of CIETC during 2004 and had reviewed a draft of employment contracts. According to Mr. Kincheloe, the DOL approved a draft contract with salary amounts left blank. He also noted that his firm had confirmed with a DOL representative in a telephone interview that CIETC management was acting in accordance with federal requirements. Mr. Kincheloe stated that he did not believe that the audit had revealed improprieties necessary to notify the board or the Office of State Auditor.

Mr. Kincheloe stated that his firm was aware that compensation amounts paid to CIETC employees were high, and assumed that Mr. Brooks was authorized to approve the expenditure of supplemental wage payments to CIETC employees. He noted that employment contracts were not effective during the period of the audit. Mr. Kincheloe acknowledged that personnel from his firm did not witness Ms. Howard routinely reviewing invoices, did not verify that Mr. Brooks' signatures authorizing supplemental wage payments were genuine, did not verify that DOL had approved the compensation amounts, did not know if his firm had reviewed the organization's bylaws to determine if Mr. Brooks had the requisite authority to approve supplemental wage payments, did not aggregate the amount of supplemental wage payments received by CIETC employees, and did not raise the issue of supplemental wage payments to the Board in the annual report and presentation to the Board. He noted that his firm had reviewed Board minutes, but was not certain if compensation was mentioned in the minutes. He believed that his firm may have interviewed other Board members that may have included Ms. Howard, regarding the compensation amounts paid to CIETC employees, but that he could not be certain without reviewing the firm's working documents.

Secretary/Treasurer of CIETC Board

Ms. Sherry Howard, an Administrative Officer for the Story County Board of Supervisors, has served as the Secretary/Treasurer for the Board since January 2003. Ms. Howard stated that during the period of the investigation she spent approximately four hours a month performing her duties as a Board member and Officer, that included time spent attending Board meetings. She stated that initially in the position of Secretary/Treasurer she routinely signed each invoice requiring to be paid, but that in July 2003, Ms. Ramona Cunningham and Mr. John Bargman informed her that the State of Iowa was installing a new accounting system and that she would need to follow a new procedure that required her to sign a blank sheet of paper authorizing a log of payments that had already been paid, and after that time she no longer reviewed individual invoices. According to Ms. Howard, she assumed these expenditures included operational expenses, did not include payroll payments, but may have included credit card expenses. Ms. Howard stated that it never occurred to her that the new process was inappropriate. Ms. Howard also stated that she had nothing to do with the preparation or submission of financial documents to the Board that was a duty performed by Ms. Cunningham. Ms. Howard stated that she had no knowledge of employee compensation amounts and that no one had interviewed her about the practice of approving supplemental wage payments. She stated that the issue of compensation was not raised by Faller & Kincheloe, P.C. during their presentation and report to the Board.

Financial Reforms and the Future of CIETC

Ms. Mary Gottschalk, of MCG Strategic Services, provided a brief opening statement to the Committee. Ms. Gottschalk described her career positions, and stated that her firm, in cooperation the Des Moines Area Community College, had been retained by the Board, on an interim basis, to review and establish accepted administrative and financial practices for the organization, including financial management and control structures. She is to receive \$7,000 per month in compensation. She estimated that CIETC currently employs 40 persons who are directly managed by the organization. Ms. Gottschalk stated that her firm is engaged in a comprehensive review and reconciliation of all CIETC employee salaries and positions as compared with the salaries of comparable positions within IWD. Ms. Gottschalk noted that performance evaluations were irregularly conducted and often were not seriously completed. She commented that in some cases salaries were higher than comparable positions and in other cases salaries were lower than comparable positions. Committee Members discussed the appropriateness of immediately increasing position salaries. Ms. Mary Gottschalk believed that the number of open senior managerial staff positions would be reduced.

Ms. Gottschalk also discussed CIETC's accounting program and control systems that were developed by Ms. Dessert. She commented that FundWare was a standard accounting program that could be developed to aggregate amounts for standard business categories, including payroll and operational expenses, but that CIETC's system was not developed to provide those aggregate amounts, to aggregate such amounts was a time-consuming exercise, and that such a system would make it difficult for an auditor to examine financial records.

Ms. Gottschalk stated that the Board (Local Elected Officials) and the Regional Workforce Investment Board (WIA) would meet on July 21st in compliance with a deadline set by Mr. Dave Neil, Director of IWD, who has expressed a strong desire to award a contract for the management of the PROMISE JOBS Program under new management or another entity presumably selected through an RFP process by September 1, 2006. She noted that without

the contract to manage the PROMISE JOBS Program, CIETC would no longer be a viable organization.

OTHER BUSINESS

Committee Members engaged in a general discussion of the future direction of the Committee relative to CIETC. Members expressed interest in considering more information regarding the proposed use of approximately \$200,000 deposited in an economic development foundation to support Executive Branch salaries.

ADDITIONAL INFORMATION

Committee meetings involving CIETC are being recorded, and can be linked via the opening page of the General Assembly's internet homepage. A website address for the recorded meetings is: <http://www4.legis.state.ia.us/lfb/SubCom/related links/OversightRecordings.html>.

NEXT MEETING

The meetings scheduled for Monday, July 24, 2006 and Tuesday July 25, 2006, and Monday July 31, 2006 and Tuesday August 1, 2006, were cancelled. The Chairpersons will determine the next meeting date.

ADJOURNED

Representative Alons adjourned the meeting at 3:15 p.m.